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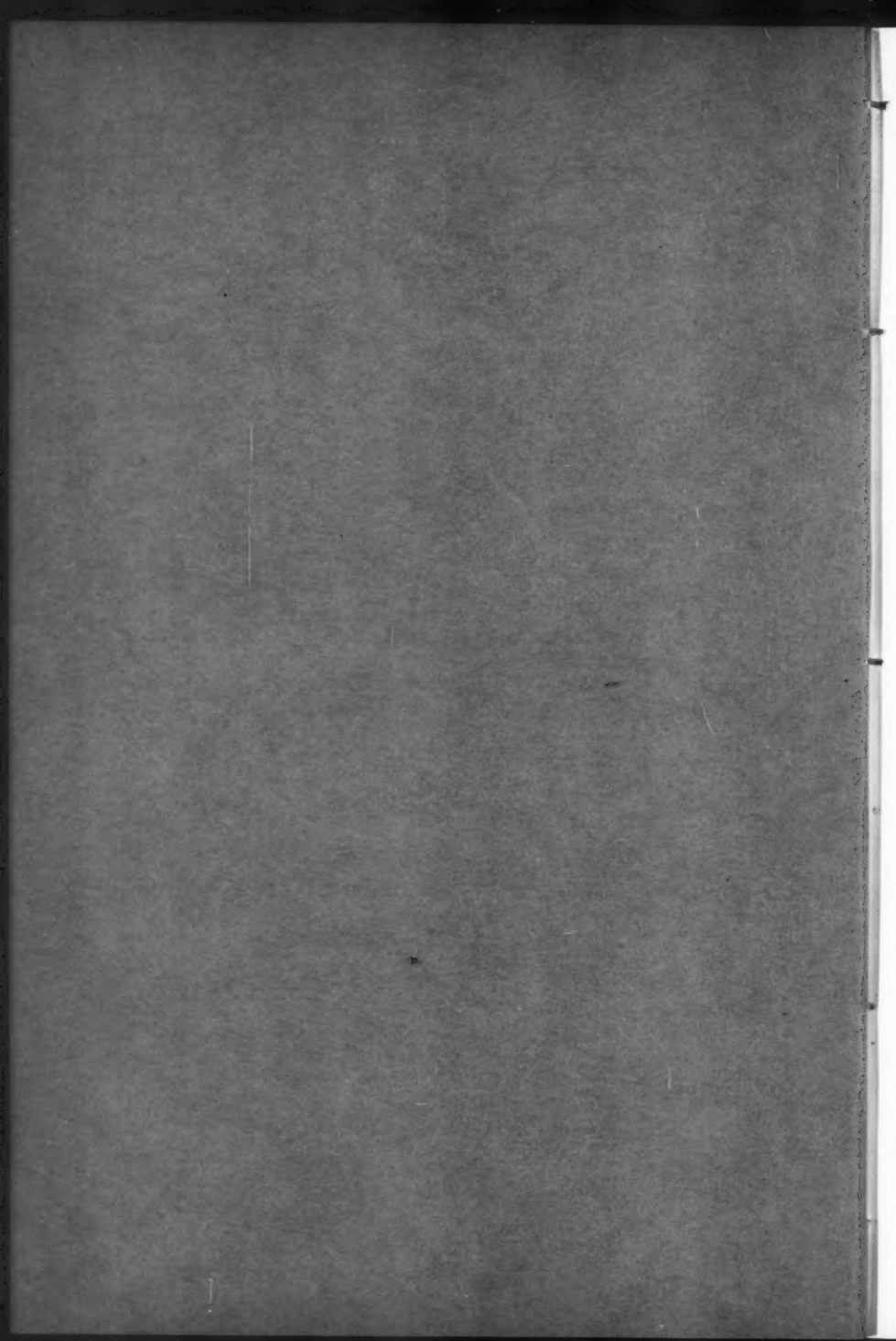
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L. R. B. & M. JOURNAL

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Development of the Accounting Profession in the United States

By WILLIAM M. LYBRAND

An address delivered at the annual meeting of the Dominion Association of Chartered Accountants, held at Quebec, September 10-12, 1924

Mr. President and Gentlemen:—Before I begin my remarks, I might say that I asked your President how long I was expected to speak, and he said that I was to be the judge. Some of you may have noticed this quantity of material which I brought with me, but I want to assure you that this is not the manuscript of my address; it is simply some data to which I may refer if necessary, if my memory fails me.

It is really a pleasure to be here today, and I say that in all sincerity, I think it is the first occasion on which I have addressed an association on, what I was going to call, foreign soil, but that is not the right term to apply to the Dominion of Canada. Our mutual faith and trust is such that our border line lies unguarded from either side all the way across the continent; it is crossed so frequently from north to south and from south to north that we cannot think of each other as foreigners; we look upon ourselves as friends who, because of some circumstance, happen to be living in different parts of the same great country.

I am here today in a dual capacity: first, in response to the kind invitation of your committee on arrangements, and second, as a delegate or representative from the American Institute of Accountants. In that latter capacity I want to extend to all of you the greetings of the American Institute. I know that many of our members would like to be here if

they could, but, as you know, the annual convention of that association begins soon in St. Louis and their faces will be turned in that direction. I have great pleasure in extending an invitation to all of you who are here and to all the other members of your association to attend that convention, if you can do so.

In considering what I should say to you today I concluded that, instead of talking on some technical subject, about which I would know no more than yourselves, you might be interested if I were to tell you something of the more recent progress or development of the accounting profession in the United States.

In speaking along this line, it seems natural that I should dwell first upon the activities of the professional associations, and in doing so, proper that I begin with the American Institute of Accountants. Always an important factor in the history of accounting, it can be claimed with confidence that the influence of this organization becomes greater as the years pass—and the year now ending is no exception.

The various features of its work will be referred to as they occur to me, not necessarily in the order of their importance.

One development which I believe appeals to all the members is the enlargement of the bulletin issued by the Institute from month to month. These bulletins do not take the place of the magazine, "The Journal of Account-

ancy," which contains articles and other material of a technical character, they serve to supplement that publication. The bulletins report chapter activities; they advise the members of court decisions of which accountants should be informed and they carry other news of general interest to the profession.

It has been stated at times that the Institute has not been particularly interested in the certified public accountant laws of the various states. Such statements, however, must have been made under a misapprehension or through lack of knowledge of the work of the Institute along these lines. It has endeavored to stimulate interest in such laws and has been of material assistance in the preparation of the bills which afterwards became state statutes. It has cooperated actively in the matter of state examinations; in fact, to such an extent that the Institute examination questions are used in thirty-four states and the Territory of Hawaii. Several state laws and the Hawaii law specifically provide that the Institute's examinations shall be used.

The Institute was an effective agent in putting a stop to the activities of the National Association of Certified Public Accountants, an organization which, from the District of Columbia, attempted to issue, and in fact was issuing so-called C. P. A. certificates of such a spurious character that about the only real qualification required was the payment of a ten dollar fee.

An outstanding development in the work of the Institute during the year was the organization of the bureau of public affairs under the direction of the committee on public affairs. I cannot describe the work of this bureau better than to quote from reports of the Secretary and the chairman of the committee:

"The bureau seeks to develop favorable public opinion with respect to the profession and its individual practitioners and the education of the public to the advantages to be derived from the greater use of accredited practitioners. It seeks, in general, the opening of new ways and the development of old ways in which accountants may serve the public. The committee on public affairs endeavors also to make fully available for public purposes the technical and other resources of the American Institute of Accountants. It tries in this way not only to render a public service for which its members and associates are specially fitted, but to bring the work of the Institute and of practicing accountants favorably to the attention of the public.

"Carrying out the policies outlined above, the committee on public affairs issues from time to time letter-bulletins on subjects of popular interest which accountants are peculiarly fitted to solve. Two of these bulletins have made their appearance. The first is on 'Commercial Arbitration' and outlines the services that accountants may render in assisting in the settlement of commercial disputes. The second is on 'The Crime Tendency' and gives definite information as to losses to business through office crimes, including defalcations, embezzlements, forgeries, credit frauds and stock frauds, and suggested remedies by which these losses may be reduced. Some of the methods for reducing these losses are suggested by the committee; others are definite suggestions made by surety companies, bankers and credit men.

"Both of these letter-bulletins were impersonal documents of an informative character, the distribution of which by members and associates of the Institute falls within the limits of the rules of conduct, there being no prohibition against the circulation of such publica-

tions. The distribution of these two publications has put the Institute and its individual members and associates in direct contact with many public organizations, business firms and individuals. Their publication is looked upon as a distinct contribution by the profession of accountancy in the two fields which they cover. Much favorable comment has been heard on the constructive labors of this committee. The committee on public affairs is studying other topics which will be made the subject of forthcoming letter-bulletins, such as the appointment of accountants as receivers and trustees, municipal and private business budgeting, and fiscal years as contrasted with calendar years."

The report of the special committee on administration of endowment contains interesting information regarding the activities of that committee. During the year a prize was offered for the best paper on the subject of "The principles which should govern the determination of capital and the amounts available for distribution of dividends in the case of corporations with special reference to the system of capital stocks without par value." The paper which was awarded the prize may be found in the "Journal of Accountancy," published by the Institute, so no attempt will be made to summarize it here. In the report of this committee, reference is also made to the preparation of a supplement to the "Accountants' Index," to the installation of a circulation department in the library, and to the bureau of information which answers inquiries received from members, of which during the year there were over two thousand.

The Institute's committee on cooperation with bankers, at the request of the Robert Morris Associates' committee on cooperation with public accountants, supplied answers to a series of questions

asked by the bankers with relation to technical accounting procedure. The detailed information given by the Institute appears in the May number of the Institute bulletin. Doubtless copies of this bulletin may be obtained from the Secretary of the Institute, if anyone here desires to know exactly what questions were asked and what answers were made thereto.

The Institute has undertaken the work of making a thorough and careful survey of court decisions of interest to accountants and is reprinting them in its bulletins. It has made a digest of the corporation laws of the states and of the District of Columbia. The printing and distribution of this information are yet to be arranged. It has prepared a form for a Consolidated Corporation Tax Return to include information required by all states.

Deans of schools of accountancy are to be invited to contribute articles to the Journal of Accountancy describing the curricula and activities of the colleges and schools in the hope of giving the student body and accounting professors a larger part in the work of the Institute. The Institute secured a list of names and addresses of students of accounting schools and sent them names of books suggested for summer reading.

No doubt you all know that there is another national organization in the United States, The American Society of Certified Public Accountants, which came into the field at a considerably later date than the American Institute of Accountants. This society has already built up a large membership, which is increasing from month to month. The object of this society, as stated in its constitution, is "to protect the certificate of certified public accountants granted by the states and other political subsidiaries of the United States, to improve the

standards of the accountancy profession and to assist governmental authorities in regulating public accounting practice." To become a member of this organization the accountant must have obtained a C. P. A. degree. He does not thereby, however, automatically become a part of the organization, but he must apply for membership and be elected in the regular way. In the management of this organization the state is the unit, provision being made for representation by states, based in part on the number of members in each state.

Whether or not two national organizations are needed in the United States is a matter to which very serious consideration must be given. Unless the societies are organized and do their work along entirely different lines, it seems certain that there will be duplication of work and waste of effort. The American Society issues its own publication, for instance, and many of its activities are along substantially the same lines as those of the American Institute. The only reason for two organizations would be conditions in the accounting profession which make it impossible for one organization to represent and serve all qualified practitioners.

The New York State Society is the largest state organization. It is to be expected, therefore, that it would be active and influential in work designed to increase its service to the public, to the profession at large, and to its own members. One matter of interest during the year was the adoption of a code of ethics or rules for professional conduct. In this connection, it is interesting to quote the resolution on principles for business conduct adopted by the Chamber of Commerce of the United States on May 8, 1924. The principles set forth in this statement are so sound that I venture to read them to you:

"The function of business is to provide for the material needs of mankind, and to increase the wealth of the world and the value and happiness of life. In order to perform its function it must offer a sufficient opportunity for gain to compensate individuals who assume its risks, but the motives which lead individuals to engage in business are not to be confused with the function of business itself. When business enterprise is successfully carried on with constant and efficient endeavor to reduce the costs of production and distribution, to improve the quality of its products, and to give fair treatment to customers, capital, management, and labor, it renders public service of the highest value.

"We believe the expression of principles drawn from these fundamental truths will furnish practical guides for the conduct of business as a whole and for each individual enterprise.

- I. The foundation of business is confidence, which springs from integrity, fair dealing, efficient service, and mutual benefit.
- II. The reward of business for service rendered is a fair profit plus a safe reserve, commensurate with risks involved and foresight exercised.
- III. Equitable consideration is due in business alike to capital, management, employees, and the public.
- IV. Knowledge—thorough and specific—and unceasing study of the facts and forces affecting a business enterprise are essential to a lasting individual success and to efficient service to the public.
- V. Permanency and continuity of service are basic aims of business, that knowledge gained

may be fully utilized, confidence established and efficiency increased.

- VI. Obligations to itself and society prompt business unceasingly to strive toward continuity of operation, bettering conditions of employment, and increasing the efficiency and opportunities of individual employees.
- VII. Contracts and undertakings, written or oral, are to be performed in letter and in spirit. Changed conditions do not justify their cancellation without mutual consent.
- VIII. Representation of goods and services should be truthfully made and scrupulously fulfilled.
- IX. Waste in any form—of capital, labor, services, materials, or natural resources,—is intolerable, and constant effort will be made toward its elimination.
- X. Excess of every nature,—inflation of credit, over-expansion, over-buying, over-stimulation of sales,—which create artificial conditions and produce crises and depressions, are condemned.
- XI. Unfair competition, embracing all acts characterized by bad faith, deception, fraud, or oppression, including commercial bribery, is wasteful, despicable, and a public wrong. Business will rely for its success on the excellence of its own service.
- XII. Controversies will, where possible be adjusted by voluntary agreement or impartial arbitration.
- XIII. Corporate forms do not absolve from or alter the moral obligations of individuals. Responsibilities will be as courageously and conscientiously discharged by those acting in representa-

tive capacities as when acting for themselves.

- XIV. Lawful cooperation among business men and in useful business organizations in support of these principles of business conduct is commended.
- XV. Business should render restrictive legislation unnecessary through so conducting itself as to deserve and inspire public confidence."

Another important feature of the work of this society during the year was the adoption of a motion permitting the President to appoint a number of committees on technical subjects, each committee to be composed as far as possible of members of the society specializing or particularly interested in one or more subjects. It was not the intention that these committees should report at any particular time. Some subjects would necessarily require more study than others. Questionnaires were sent to the members asking them to indicate the choice of committees on which they would be willing to serve. Over two hundred replies were received and from these the President appointed the large number of forty-two special technical committees. The results of the work of these committees as they are presented from time to time to the members should prove to be of the greatest interest and value.

During the year an all-day-and-evening conference of the society was held at Columbia University. The purpose of this meeting is described in the following quotation from the President's report:

"The meeting was called to present, discuss and clarify the purposes, objects and future policies of the Society, including the consideration of the report of the Legislation Committee. Discussion and action on the important matters before the meeting by the large number of mem-

bers who were present was of inestimable value to the furtherance of the year's program of activities. An interesting and instructive part of the program was the exhibit of the work of the Department of Accounting of the University and the unique display of old books on accounting arranged by members of the faculty in accounting. Such a conference might well be made an annual event."

If any of the members of your organization are interested in the attitude of the accountant in question toward bankruptcy procedure, arbitration and relationship with business associations such as the Credit Men's Association, it is suggested that they obtain a copy of the President's report in which all these matters are dealt with at length and in a most interesting manner.

Another development in the United States has been the endeavor to enact state laws which will restrict the practice of accounting to those licensed by the state. Such a bill passed both houses of the New York Legislature, but was vetoed by the Governor. The proposed bill, drafted by the New York State Society, was revised later in cooperation with Dr. Augustus S. Downing, Assistant Commissioner and Director of Professional Education of the State of New York. It was not a monopolistic measure; in fact, it was quite the reverse. As drafted and amended, it was broad enough to include every bona fide accountant, but it retained restrictive features designed to protect the public. It received the hearty support of prominent business men, lawyers, bankers and business organizations. The Governor vetoed it mainly on the ground that, in his opinion, such a law was not vitally needed. He contended that the letters C. P. A. or the words certified public

accountant used by an accountant in connection with his name were sufficient to differentiate him from one who had not that title, and the business or professional man who required the services of an accountant, thereby being put on notice, could then employ either a certified or a non-certified accountant, as he saw fit.

It is believed that the bill, as amended, was satisfactory to a vast majority of the practicing accountants in the state. The principal opposition came from accountants who are privately employed but who do some accounting work on the side. It was feared by them that if such a law were passed, they would not be able to obtain the degree and would thereby be prevented from continuing their outside accounting work. I believe they were unnecessarily fearful. It seems hardly probable that the work they do would be construed to be the public practice of accounting of such a character as would subject them to the law's restrictions, if it consisted of work done solely for their clients' use and not for credit purposes nor for public presentation.

Notwithstanding the veto of the Governor, I am convinced that a law more or less similar to the one proposed will be enacted within a reasonably short time. It is a step in advance toward the goal which accountancy should ultimately reach, a goal that would place it on a par with the other professions.

The State of Maryland did enact a law on substantially similar lines during the last session of its legislature. This law differed, however, from the New York bill in its method of dealing with the two classes of accountants who are found in every state, namely, those having the certified public accountant degree and those who practice without any such title. In the Maryland law

provision was made permitting certified public accountants of that state, or of states having provisions similar to the Maryland law, to come in under the law and be known as certified public accountants. All those who were not certified public accountants were segregated under a class called public accountants. All such men can register as public accountants, but apparently after January 1, 1925, it is intended that no additions shall be made to this class, anyone wishing to begin the practice of accountancy after that date being obliged first to comply with the provisions of the law and obtain the degree of certified public accountant. In the course of time, the public accountant class will diminish, finally disappear, and there will be certified public accountants only.

The Maryland law is interesting in one other respect. It has been believed that the work of accountants should be dealt with as privileged communications, but the Maryland law is the first, to my knowledge, in which such provisions have been definitely embodied. In the act it is provided that

"Except by express permission of the person employing him . . . a certified public accountant . . . or person employed by a certified public accountant . . . shall not be required to and shall not voluntarily disclose or divulge the contents of any communication made to him by any person employing him to examine, audit or report on any books, records or accounts, nor divulge any information derived from such books, records or accounts in rendering professional services."

What I have heretofore said has related chiefly to the progress of accounting as reflected in the activities of associations and in legislation. Progress

has also been made in private practice as respects accounting procedure and the scope and responsibility of the work of an accountant. We only have to cast our thoughts back a few years to realize how much we have advanced in the character of the work we do and the kind of services we render to our clients. Years ago most of the work done by accountants consisted of audits made primarily for the purpose of determining the integrity of the accounts. Comparatively little was done in the way of constructive work and the reports, as a rule, did not contain suggestions which would be helpful to the client in the conduct of his business.

I can safely say now that the tendency is exactly the other way. I do not mean to say that the integrity of the accounts, as set forth in a balance sheet, does not need to be determined, but there is less detailed auditing and more constructive work. Such work is what the client values most.

I was much interested in reading something along this line in a bulletin issued by Haskins & Sells. In this article it was pointed out that while in the earlier days accountants were more or less tied down by what they considered to be the traditional requirements of their work, they now go far beyond the mere verification of facts and figures. It is pointed out that there can be no comparison in the mind of the client as to the value of the work where in one case the report consists of a mere recital of what was done to verify the accounts, with perhaps some tabulations of figures appended, while in the other case the report is full of helpful suggestions of a critical or constructive character. In our own practice, and I have no doubt it is true of other accountants, it has become apparent that more constructive work must be done. Figures must

be analyzed not merely to show results, but they must be presented in such a manner that from them the accountant may point out to the client how changes may be made that will be advantageous to the business.

The field of cost accounting appeals strongly to those who work along constructive lines. The term "cost accounting" is no longer sufficiently broad, inasmuch as it includes usually more than the mere finding of costs; in fact, the function of cost accounts now is generally recognized to be not alone the ascertainment of results, but to furnish information in advance which may help to change conditions and improve the results. It has been aptly described as current news contrasted with history.

The need of some organization which would devote itself primarily to the study and development of cost accounting and kindred subjects led to the formation of the National Association of Cost Accountants. Its membership consists of public accountants who are engaged professionally in cost work, industrial cost accountants who are in charge of all or part of cost accounting in any business organization, business executives, industrial engineers and teachers of accountancy. The second group is the largest, comprising, as it does, more than fifty per cent. of the total membership.

I am especially interested in the National Association of Cost Accountants because I was its President for two years and, during that time, I realized more and more what useful work could be and was being done by this association. You know, I believe, that the Canadian Association of Cost Accountants is affiliated with it under an arrangement whereby the Canadian Society secures the literature and service of the American Association.

The National Association of Cost Accountants has had a very rapid growth. It was formed in the latter part of the year 1919 with 35 members. It is now only five years old and has over 3,200 members. It has 23 local chapters in the United States and 1 in Honolulu. All the chapters hold monthly meetings during the eight months from September to May of each year.

The association publishes a year book annually and two bulletins and one cost literature bulletin each month. It is now issuing nearly two thousand pages of printed material each year.

A research department is maintained which has been accumulating useful cost information, including the collection of about 150 uniform cost systems. The research department also undertakes to answer inquiries from members, and each year handles from three hundred to five hundred questions. The literature published by the association is varied in character. Even though each publication may not relate to a subject which is of interest to every member, nevertheless in nearly all of them there is something of interest or value for every reader. As an indication of the variety of topics dealt with, I will read a few of the titles of the official publications:

<i>Date of Issue</i>	<i>Title</i>
June, 1920.....	Industrial Accounting as an Aid to Management
August, 1920.....	Accounting for By-Products
December, 1920....	Managerial Uses of Foundry Costs
February, 1921....	Some Problems in the Actual Installation of Cost Systems
April, 1921.....	A Bibliography of Cost Books
June, 1921.....	Cost Accounting for Fruit and Vegetable Canners
July 1, 1921.....	A Method of Distributing Factory Payroll
August 1, 1921....	Uniform Cost Accounting Methods in the Printing Industry

September 1, 1921...Cost Methods in a Wood-working Plant
 October 1, 1921...Costs as an Aid to Management
 November, 1921...Some Cost Problems in the Hawaiian Sugar Industry
 December 1, 1921...Some Phases of Cost Accounting in the Chemical Industry
 January 15, 1922...Relation of Budgetary Control to Cost Accounting
 April 1, 1922...A Premium Incentive Wage Plan
 May 1, 1922...Flour Milling Costs
 June 1, 1922...Cost Accounting in the Canning Industry
 June 15, 1922...Cost Accounting in the Oil Refining Industry
 July 1, 1922...Normal Burden Rates
 September 1, 1922...Cost Methods in a Hosiery Mill
 September 15, 1922...Woolen Mill Costs
 November 1, 1922...Cost Accounting in the Manufacture of Iron and Steel Sheets
 November 15, 1922...Steamship Operating and Terminal Costs
 January 15, 1923...Prices, Profits and Production
 May 1, 1923...Standard Costs—How to Establish and Apply Them
 August 15, 1923...A Punched Card System of Inventory Control
 September 1, 1923...Some Economic Fallacies Common Among Cost Accountants
 October 15, 1923...A Method of Costing Partially Completed Orders
 November 15, 1923...Industrial Accounting Statistics and Their Interpretation
 December 1, 1923...Cost Accounting in the Production of Motion Pictures
 January 15, 1924...Getting the Most Out of Business Records
 April 1, 1924...Industrial and Financial Investigations
 May 1, 1924...Budgetary Control
 June 1, 1924...Methods of Supplying Cost Information to Foremen
 July 1, 1924...Use of Accounting Information and Statistical Data in a Department Store
 July 15, 1924...A Basis for Cost Accounting in Banks
 August 1, 1924...Importance of the Cost of Idleness in Equipment Industries
 August 15, 1924...Controlling the Labor

In concluding, I would say if I were to endeavor to sum up in one sentence

the progress of accounting in the United States, it would be that such progress or development is distinctly along the line of rendering more service to the clients and to the public. After all, "service" is the key word. Development in association activities, changes in legislation, improvements in accounting and auditing procedure, will mean little unless they result in better service to the clients and to the public.

Roger W. Babson on the Business Outlook for 1925 *

From Mr. Babson's characteristic method of pouring forth his points of view on future business and financial life as indicated from his statistics, the following comments were jotted down. Incidentally, he expressed the opinion that his grandchildren would see the largest city and the greatest world trade on the Pacific Coast, even surpassing that of Greater New York.

The country is still in a period of readjustment. "Easy money" or "repeat" businesses such as dairy, light, and public utilities, bakeries, etc., have prospered and will continue so to do.

The depression is now only 75 per cent. complete with indications that a better feeling and improvement in business would exist from now on. He cautioned all that if another period of inflation was created, the country would be thrown deeper into this depression period and harder times would exist.

Commodity prices as a whole will have a downward trend, not a gradual or steady route, but like the teeth of a saw. At present, we are at the vortex and prices will rise a little, then sink to a lower level.

(Concluded on page 16)

*Notes made by R. G. Ladd of our New York office at a recent lecture by Mr. Babson.

The L. R. B. & M. Journal

Published by Lybrand, Ross Bros. and Montgomery, for free distribution to members and employees of the firm.

The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvement; to encourage and maintain a proper spirit of cooperation and interest and to help in the solution of common problems.

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The New Partner

On January 1, 1925, E. Elmer Staub, brother of Walter A. Staub, one of the resident partners at the New York Office, was taken into the partnership of our firm. Mr. Staub, whose picture is shown opposite, accompanied by his eldest son E. Milton Staub sailed on the S. S. Deutschland, January 8, to assume his duties as resident partner of the new Berlin office. As such news is always of interest to the members of our various staffs, we take pleasure in representing a brief resumé of Mr. Staub's past history as taken from "Steel and Garnet," his alumni bulletin at Girard College:

"That world developments affect the lives of Girard alumni, as well as of others in the business and financial world, is evident from the recent announcement that E. Elmer Staub, of the class of 1899, is going to Berlin, Germany, to be the resident partner there of the firm of Lybrand, Ross Bros. & Montgomery.

"This firm, which is today one of the best known firms of public accountants in the country, was organized in the city of Philadelphia almost twenty-seven years ago and, despite the fact that its organization now stretches from the Atlantic to the Pacific, this city is still looked on as the home of the firm. In view of the probability of the development of close relations between American and German business in the next few years, and particularly of the possibility of considerable financing of German industries by American capital, the firm of Lybrand, Ross Bros. & Montgomery has decided to open an office in Berlin, Germany, which will serve as headquarters for the carrying out of engagements in any part of Central Europe.

"In deciding who would be best fitted to undertake the task of representing the

firm in this new venture, Elmer Staub was selected. In addition to his years of training with the firm and his subsequent experience in a most responsible connection with the Hudson Motor Car Company in Detroit, Mr. Staub's command of German made him seem the logical man for the commission.

"Girard alumni have been identified with the "L. R. B. & M." firm throughout most of its history. Early in 1901 when the firm was still young and its



organization relatively small—its only office at that time was in Philadelphia—Walter A. Staub, of the class of 1897, and a brother of Elmer, entered the firm's employ as a junior accountant. In 1911 he became a member of the firm and is such at the present time. He is now located in New York.

"A few years after Walter Staub had entered the employ of the firm, Elmer also became a member of its staff. He advanced rapidly, going to the New York office in 1908, being placed in charge of the Pittsburgh office in 1911

and later in charge of the Chicago office. While in the latter position, one of the firm's clients was so much impressed with the service performed by Elmer Staub that it finally after much persuasion, induced him to leave the public accounting field and join its organization. This was in 1915 when he became accounting manager of the Hudson Motor Car Company. That the value of his service to the company has been recognized is evident from the fact that for some years past he has been one of its directors.

"Now after ten years in the automobile field—with all the experience in the accounting and financial aspects of that industry which that period brought with it—Elmer Staub returns to the public accounting field. This move is in response to the invitation which has come to him to become a partner in the firm of Lybrand, Ross Bros. & Montgomery and to represent it in carrying on its European practice. Mr. Staub sails for Germany right after the Christmas holidays and as he goes we wish him every success in this new venture."

Contractions

A short time ago there appeared in a magazine article by Professor William Lyon Phelps, of Yale University, the following paragraph:

I nominate for the Ignoble Prize the accursed shortening of the beautiful name San Francisco to "Frisco." I do not know of any abbreviation quite so irritating.

This opinion by one of the authorities of the present day on English Literature is one with which San Franciscans agree entirely. No better approval can be secured than from those people who live in and love this fine city.

Importance of the Verification of Inventories

An address given by Walter E. Sachs, Esq., of Goldman, Sachs & Co., New York, before the New York State Society of Certified Public Accountants, October 15, 1924

The opportunity to say a few words to this representative group of accountants is one that I grasp with a considerable degree of eagerness. It is a distinct pleasure to me to meet this gathering—it is like seeing old friends, for I have become familiar, after many years of statement reading, with the signatures of many of the firms with which you are affiliated.

Representing, as I do, a house which has been judging credits for over half a century, and which, during that period, has been considered in the forefront of any movement to improve conditions under which credit is granted, I know you will bear with me if I touch briefly on one point on which, in my opinion, there is still room for very great improvement. I refer to the manner of verification of and certification to the correctness of inventories.

The general topic adopted for discussion at your conference today is, I understand, that of "Commercial Frauds." I can think of no item in the balance sheet of a merchant or manufacturer that lends itself more readily to misrepresentation than the item of inventory, and none where such misrepresentation might more easily escape detection. The verification of liabilities and the analysis of accounts and notes receivable are simple matters for the accountant, in comparison to a verification of the quantities and a determination of proper values of merchandise, raw material, and goods in process.

There would appear to be no more intricate question than the determination of varying methods of valuation in different types of goods. A universal rule of "cost or market, whichever is lower" can

hardly be adopted. There are occasions, in great inflationary periods for instance, when even such a standard is hazardous—when special inventory reserves should be set up against the day of rapid deflation. The accountant must therefore display, it appears to me, in regard to inventory certification, better judgment than in any other department of the audit. He must become something of a merchant as well as an economist in considering inventory valuations.

This difficulty regarding the inventory item has been recognized by bankers and accountants for years past. Nevertheless, little progress, it appears to me, has been made in a standardization of certificates as they refer specifically to inventory. I think it would be quite possible to select at random fifty balance sheets bearing the certificates of different accounting firms and find fifty totally divergent methods of phraseology in regard to the inventory items.

In this discussion I need hardly stress striking cases of misrepresentation of inventory, such as the inclusion, in the item of accounts receivable, of amounts owing a parent company by subsidiaries, which are really to be included as part of inventory. An outstanding case of this type was reflected in the audit of a large manufacturing concern that markets its goods through its own chain of agencies and retail stores. These agencies and stores are owned by subsidiary companies, the capital stock of which is owned, in turn, by the parent company. The statement of the parent company for years included in its accounts receivable item several million dollars of accounts receivable owing by the subsidiaries,

when in fact these accounts represented, to the extent of at least 50 per cent., merchandise carried in the retail stores. Naturally, the statement presented an entirely incorrect picture of the company's inventory and of the relation of the inventory to annual sales. And yet, it was only after some effort on the part of the banks giving credit to this company that the company's officials, as well as its auditors, were persuaded to set up clearly the amount of "merchandise at company's agencies and stores." This was done in the parent company's consolidated balance sheet—a procedure that disregarded the fiction set up by the subsidiary companies.

Nor need I mention so pure a fiction as that of a tanning concern which consigned hides to affiliated companies, taking advances from the latter against the process of tanning, and listing as the amount of inventory in its own statement the total of hides, less advances—that is to say, the net amount of inventory only.

I need hardly refer to such gross misrepresentation as the recording of fake sales just prior to the time of taking inventory and of making statements—that is to say, padding accounts receivable and depleting inventory, and reversing the process immediately after statement date through so-called "returns."

Such frauds and misrepresentations as those just indicated, and others of a similar nature, can usually be discovered, I believe, by an alert accountant, particularly after a working knowledge of a business has been acquired over a reasonable period of time.

Hardly less objectionable in its tendency to misrepresent was the custom adopted in certain packing-house audits of stating the inventory item as "merchandise, including consignments, less drafts drawn thereagainst." In one case

such consigned merchandise, had it been added to the total inventory figure as should have been done, would have increased the inventory almost 80 per cent.—and would have increased liabilities to the extent of many millions of dollars.

I do wish, however, to refer specifically to the verification of quantities and values, and to the phrasing of certificates as they relate to those two points. The banker wants nothing more than a clear-cut statement of fact, a plain, easily understood explanation of what the accountant has or has not done in connection with inventory verification.

I recall a certificate which stated that the accountant had "audited the books and accounts of and we certify that the above balance sheet sets forth the true financial condition of the company at that date." Apparently nothing could state more clearly the completion of a comprehensive audit. Yet, as a matter of fact, the accountant had never checked up or made any tests whatsoever of the inventory. He had merely accepted figures as submitted by the president of the company. It developed later that this official, the company's chief stockholder (it was a close corporation, with only three or four stockholders in all), had systematically padded the inventory figures over a period of three or four years, meanwhile paying large dividends. And yet, two months before the crash came, the accountant had stated in his certificate that the balance sheet "set forth the true financial condition." What could have been farther from the truth? The balance sheet failed as completely to reflect a true condition as if the accountant had omitted to set up adequate reserves against long overdue or uncollectable accounts receivable, or had neglected to list all notes payable.

It appears to me that the form of blanket certification just referred to is the most dangerous type of all. Far better that the certificate contain a frank admission that inventory was not verified, but merely accepted as submitted by officials of the company. This is frequently done in a very clear and concise manner. Thus, I have seen certificates reading, "We have examined the books and records of for the year ended We hereby certify that, subject to the inventories, *which we did not verify*, the above balance sheet fairly sets forth the financial condition of the company"—not a complete audit to be sure, but at least the credit-giver is definitely put on notice as to its incompleteness.

It stands to reason that the ideal certificate is that in which the accountant clearly and definitely states that inventory sheets were checked in detail with stock records, that sufficient tests were made by the accountant in respect of values to satisfy that inventory totals are correctly stated and values properly taken.

The banker realizes the difficulty of persuading every business house to submit to the extra expense and additional time involved in an actual and complete verification of inventory. I do not mean to imply that such verification must be a *sine qua non* of every accountant's audit. Bankers have extended credit in the past on faith, on a complete reliance in the standing and integrity of the borrower. Bankers will no doubt continue to give credit in special cases in that way. We cannot expect as complete an array of facts from the very occasional borrower of large means as from the borrower who is using his credit to a fuller extent. The amount of detailed information required is a business question for the credit-giver to decide. I do believe, however, that the

banker is entitled to a clear and unmistakable statement of what the accountant has or has not done. The certificate should state either that the inventory is taken as submitted by the company's own officials and that the audit reflects a true condition subject only to that reservation, or that the auditors have themselves made sufficient tests as to quantities and values to certify to the correctness of inventory figures.

I think, therefore, there should be admitted to usage only two kinds of certificates—what might be called a gold-medal certificate, on the one hand, and, shall I say, a tin-medal certificate, on the other—only we must be informed that the latter is of tin.

Right here, permit me to say that accounting firms should include in their organizations men experienced in judging various lines of merchandise. I do not see why such organizations should not have members with some experience in and knowledge of textiles, of food stuffs, of rubber goods, of iron and steel products, and so on. Such men would naturally keep in touch regularly with developments in the special trades related to such goods, and would thus bring to bear a special knowledge, invaluable in the completion of audits. I venture to say many of your firms are already so organized. I should like to see the day when no accounting firm would fail to include a number of such men.

It is difficult to understand that so comparatively little attention has been paid to inventory in the auditing of countless business concerns. When you consider that inventory is really the life-blood of most businesses, this becomes all the more startling a fact. It is true that in some types of business, inventory is of secondary importance. I refer to such businesses as, for instance, dealers in crude rubber and importers and deal-

ers in hides and skins. In the audits of such concerns, accounts receivable are naturally of first importance—for comparatively little inventory is carried for own account. But these are exceptional cases. In most businesses, inventory turnover spells the difference between success and failure, between profits and losses. Frequently, with no dishonest intention whatsoever, business men delude themselves as to the value of their stock of goods. It is far easier to determine the realizable value of cotton goods in the gray or of raw silk than it is to determine the realizable value of hairnets or of fancy buttons when the fair sex take a notion to change the prevailing styles.

And yet, auditors have, in the main, paid less attention to inventory verification than to any other phase of an audit.

The statement has been made that a certificate must contain as few words as possible—that brevity is essential for obvious reasons. It is argued that reference can at all times be had to the fuller report that usually follows the completion of an audit. It is stated that these fuller reports usually explain in detail the exact work that the accountant has performed. Accountants have told me that brief certificates are given at the special request of bankers and dealers in commercial paper themselves. I cannot agree with that point of view, and desire right here to register a protest as a dealer in commercial paper. Obviously, the fuller accountant's report cannot be broadcast to the hundreds of banks that purchase commercial paper names. These banks are furnished with copies of the audited balance sheet, bearing the usual abbreviated accountant's certificate and his signature. I believe that these banks are entitled to a plain statement on the face of the balance sheet, setting forth the type of audit that has been made. It is

customary to make a clear statement as to the status of accounts receivable. Why should it not become also a custom to make a clear statement as to what has been done in connection with inventory verification?

This could be accomplished, it seems to me, in one of two ways. Either, under the heading of Inventory in the body of the statement, there could be inserted some such wording as "Inventory at cost or market, whichever was lower, quantities and values having been subjected to tests by our auditors, so as to satisfy them as to the correctness of same" (I leave it to your ingenuity and to your command of language to greatly improve upon this wording); or, if it was considered desirable, some similar wording should always be included in the certification appearing at the foot of the balance sheet.

I can state it as a fact that dealers in commercial paper are always required to supplement the auditor's balance sheet with a statement as to inventory valuation. Banks buying commercial paper ask many questions, but none more frequently than that regarding the proper setting up of reserves against accounts receivable and that regarding the method of taking inventory. Why, therefore, should not the answers to these two universal questions be clearly anticipated on the face of the balance sheet? The one regarding accounts receivable is—why not the other? And yet, it appears to me that in seven out of ten audits, the inventory question is totally ignored.

It appears to me that this subject might well engage the particular attention of the properly appointed committees of your various accountants' societies. That such bodies as the Robert Morris Associates, the American Bankers Association, and other banking organizations are ready to cooperate with you,

there can be no doubt. Some nearer approach to standardization on this point seems to many bankers highly desirable.

In a protracted period of steadily rising prices, such as the world witnessed, with little interruption, during the first twenty years of this century, inventory value did not loom up as so important a factor. Prices usually were higher at the end of any given year than at the end of the preceding year.

But at the present time, when it is not at all unthinkable that we are only in the beginning of a period of declining price levels, or, in any case, in a period when sharp advances and declines of price levels may reasonably be expected, the question of inventory valuation looms big. It seems to me that audited statements will come to be considered as of little value in the future unless definite reliance can be placed on the certification as it relates to inventories.

The standards set up by societies of accountants are so very high, and accounting has come to be regarded, not as an occupation, but as a great and influential profession, that a unified effort to eradicate this, may I say, last point of laxity in accounting practice, is no more than the business and the banking community has a right to expect. Such an effort will be considered, I believe, the most constructive step in good accounting of the last decade, and will help to place on a still higher plane the honored calling of which you are members.

Roger W. Babson on the Business Outlook for 1925

(Continued from page 9)

The radio may offset the effects of the automobile. The latter has tended to keep people out of their homes and in

most cases carry them to the hotels, theaters and other places of amusement. A certain hotel manager informed him recently that there were less people at his hotel on election night than he usually had on regular nights before the radio era. This tendency of people to remain at home and the desire for better homes will increase house furnishing and appliance sales.

Money conditions may not be as low as 1924 but will be down for some time to come.

Wages will decrease during 1925.

The large cities are over-built and more rent signs will be in evidence in 1925. Suburban real estate will continue to prosper.

Non-taxable bonds will continue to thrive. Taxable bonds may have reached their peak. General industrial bonds may suffer from foreign competition.

Public utility outstandings will follow the same course eventually as that laid out by those of railroads. That is to say, the present first liens of public utilities will later be submerged by other liens until the properties assume the same cross-section as those of the railroads today.

During the present bullish market on stocks, he was disinclined to make comment, except that the stock market was an economic factor in the public welfare.

His advice to all was first to have money in the bank, then to have sufficient insurance, and lastly to invest in good stocks and bonds.

By all means, purchase investments outright and do not play on a margin, as over 90% eventually lose their worldly goods. Of interest in this respect is his statement that such financial houses who solicit marginal accounts must obtain new client lists every four years.

